

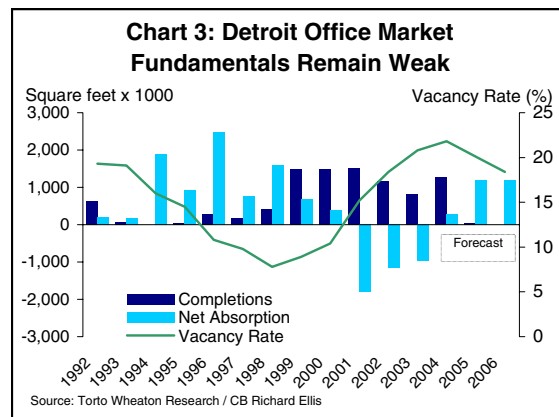
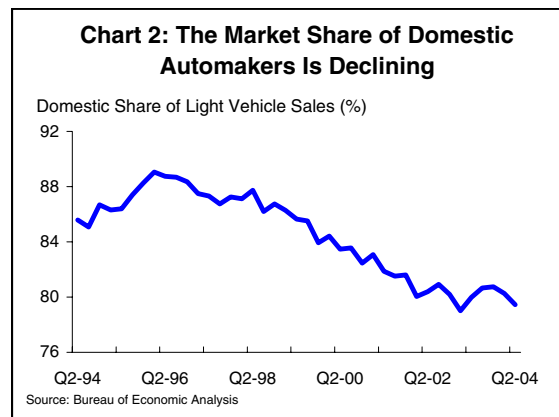
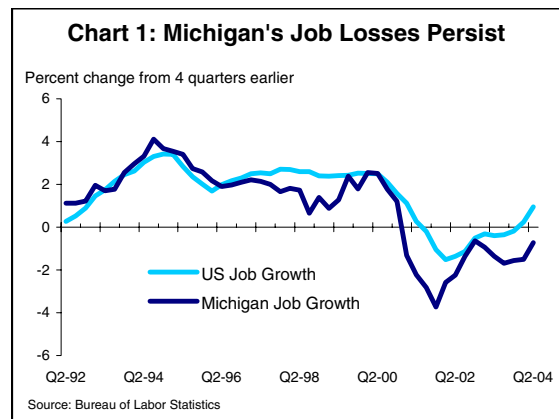
FDIC State Profile

Fall 2004

Michigan

Michigan's recovery has been weak, and significant risks remain.

- Job losses continue in Michigan while national payroll employment growth turned positive (See Chart 1). Michigan ranked 41st slowest among all states for year-over-year employment growth.
- Job losses have been occurring across most sectors. Some of the worst declines have occurred in the **Saginaw-Bay City-Midland** (-3 percent) and **Lansing-East Lansing** (-2 percent) areas. Manufacturing job losses hit these areas particularly hard, with Lansing also experiencing government job losses because of state budget woes.
- One bright spot may be **Grand Rapids-Muskegon-Holland area**, which realized a quarter of positive year-over-year job growth after roughly three years of job losses. Job growth has come amid some signs of improvement in the furniture industry and labor force growth.
- The improving economy in the Grand Rapids area is a good sign for local insured institutions, which have a median concentration of commercial real estate¹ (CRE) loans to Tier 1 capital of 425 percent. This exposure level is among the three dozen highest in metropolitan areas nationwide. Rising interest rates may particularly affect CRE credits as collateral values can decline because of higher capitalization rates, and debt service coverage can decline because of increasing debt payments.
- Although Michigan's industrial base continues to diversify, the auto sector and related industries remain a vital component of the state's economy.
- The auto sector should remain highly competitive, as domestic automakers have seen their market share decline in recent years (See Chart 2). As interest rates continue to increase, future sales may weaken. Cost cutting efforts that led to increased job outsourcing, therefore, are likely to continue.



¹CRE consists of multifamily residential real estate, construction and development projects, and nonresidential real estate.

State Profile

Detroit's challenges are substantial.

- Auto industry trends are vital to **Detroit**. As the Big 3 automakers and related companies continue to strive for efficiencies, more white-collar positions may be at risk. Sending jobs offshore is no longer solely a blue-collar issue.
- Negative absorption of office space and continued new construction have kept Detroit's vacancy rate among the highest in the Chicago Region² (See Chart 3). The downtown and suburban office vacancy rates were 24.7 percent and 20.4 percent, respectively, in the second quarter.
- The health of Detroit's small retail, office, and other commercial properties is germane to local community banks, as 68 percent of their nonfarm, nonresidential real estate loans are to small businesses and for amounts less than \$1 million.³

Earnings performance slipped in the second quarter.

- Community bank⁴ profitability was relatively strong during the past several years of economic weakness, when the median return on assets (ROA) held between 1.12 and 1.18 percent at midyears 1999 through 2003. In the second quarter 2004, however, net interest margin fell below 4 percent and ROA was well below 1 percent.
- The potential for higher second quarter earnings that Michigan banks realized through reduced provision expenses, lower overhead, and reduced tax liabilities was more than erased by declines in net interest income, noninterest income, and securities gains (See Table 1).
- Future profitability will hinge on how institutions navigate the changing interest rate environment. Rising rates are likely to pressure net interest income in coming quarters, as retail depositors seek higher yields and banks may subsequently feel compelled to raise deposit rates more quickly than usual.

Asset quality strengthened, but CRE exposures warrant close monitoring

- A bright spot in Michigan has been community bank management of asset quality. Overall past-due rates have trended down for four consecutive quarters, though delinquencies rank 13th highest among all states nationwide. Most major loan categories saw year-over-year declines in past-due rates, a leading indicator of asset quality (See Chart 4).

- Improved delinquency trends helped boost community bank reserve coverage of nonperforming loans in the second quarter to 131 percent. These developments reduce the likelihood that higher provision expenses will hamper future earnings.
- CRE exposures in Michigan are substantially higher than the rest of the Region (See Chart 5). Grand Rapids, **Ann Arbor**, and Detroit are the top three markets in the Region for CRE exposure.

Table 1: Earnings Performance Drops at Community Banks and Thrifts

Income statement contribution (as a percentage of average assets)			
	3 months ended June 30		Percentage Point Change
	2003	2004	
Net Interest Income	3.74	3.66	-0.08
Noninterest Income	1.42	1.07	-0.35
Noninterest Expense	-3.38	-3.25	0.13
Provision Expense	-0.30	-0.21	0.09
Security Gains & Losses	0.08	-0.01	-0.09
Income Taxes	-0.48	-0.36	0.12
Net Income (ROA)	1.08	0.90	-0.18

Source: FDIC

Chart 4: Past-Due Rates are Lower Across Most Lending Categories

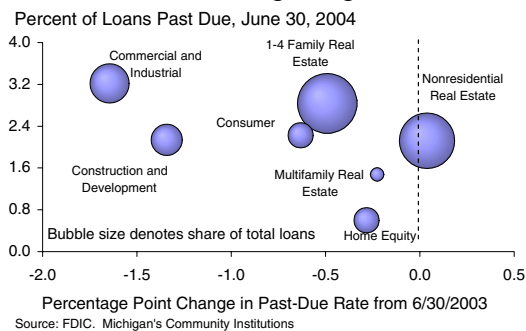
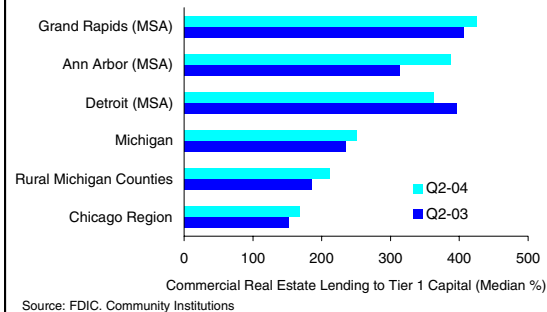


Chart 5: Commercial Real Estate Exposure is High and Increasing



²The Chicago Region consists of Illinois, Indiana, Kentucky, Michigan, Ohio, and Wisconsin.

³Small business loans as reported each June in Schedule RC-C Part II. Loans to Small Businesses.

⁴Community banks are insured institutions with less than \$1 billion in assets, excluding new (less than three years old) and specialty banks and thrifts.

Michigan at a Glance

General Information	Jun-04	Jun-03	Jun-02	Jun-01	Jun-00
Institutions (#)	176	179	181	184	197
Total Assets (in thousands)	199,714,054	194,509,713	156,868,063	169,171,663	165,718,600
New Institutions (# < 3 years)	5	9	13	22	24
New Institutions (# < 9 years)	38	39	39	38	37
Capital	Jun-04	Jun-03	Jun-02	Jun-01	Jun-00
Tier 1 Leverage (median)	9.29	8.98	8.94	8.93	9.15
Asset Quality	Jun-04	Jun-03	Jun-02	Jun-01	Jun-00
Past-Due and Nonaccrual (median %)	1.81%	2.25%	2.11%	2.06%	1.52%
Past-Due and Nonaccrual >= 5%	17	24	24	26	16
ALLL/Total Loans (median %)	1.25%	1.33%	1.30%	1.27%	1.27%
ALLL/Noncurrent Loans (median multiple)	1.71	1.33	1.45	1.64	2.57
Net Loan Losses/Loans (aggregate)	0.35%	0.56%	0.39%	0.44%	0.21%
Earnings	Jun-04	Jun-03	Jun-02	Jun-01	Jun-00
Unprofitable Institutions (#)	11	13	14	17	16
Percent Unprofitable	6.25%	7.26%	7.73%	9.24%	8.12%
Return on Assets (median %)	0.94	1.12	1.15	1.07	1.12
25th Percentile	0.66	0.71	0.74	0.76	0.79
Net Interest Margin (median %)	3.99%	4.08%	4.36%	4.28%	4.48%
Yield on Earning Assets (median)	5.65%	6.18%	6.99%	8.31%	8.22%
Cost of Funding Earning Assets (median)	1.69%	2.11%	2.67%	3.96%	3.78%
Provisions to Avg. Assets (median)	0.14%	0.20%	0.17%	0.16%	0.14%
Noninterest Income to Avg. Assets (median)	0.70%	0.89%	0.70%	0.70%	0.62%
Overhead to Avg. Assets (median)	3.00%	3.09%	3.06%	3.12%	3.05%
Liquidity/Sensitivity	Jun-04	Jun-03	Jun-02	Jun-01	Jun-00
Loans to Deposits (median %)	93.62%	88.78%	90.64%	91.76%	90.31%
Loans to Assets (median %)	74.33%	72.63%	74.48%	75.73%	74.10%
Brokered Deposits (# of Institutions)	65	62	67	57	54
Bro. Deps./Assets (median for above inst.)	7.00%	7.50%	6.88%	4.37%	7.18%
Noncore Funding to Assets (median)	19.15%	18.33%	20.15%	21.58%	21.16%
Core Funding to Assets (median)	69.04%	70.67%	68.16%	67.58%	68.26%
Bank Class	Jun-04	Jun-03	Jun-02	Jun-01	Jun-00
State Nonmember	102	102	102	102	103
National	24	26	27	27	34
State Member	29	31	32	34	37
S&L	2	2	2	2	2
Savings Bank	14	13	13	14	14
Stock and Mutual SB	5	5	5	5	7
MSA Distribution	# of Inst.	Assets	% Inst.	% Assets	
No MSA	75	11,521,852	42.61%	5.77%	
Detroit MI PMSA	39	122,111,630	22.16%	61.14%	
Grand Rapids-Muskegon-Holland MI	19	44,188,999	10.80%	22.13%	
Ann Arbor MI PMSA	12	2,641,130	6.82%	1.32%	
Lansing-East Lansing MI	10	7,540,842	5.68%	3.78%	
Saginaw-Bay City-Midland MI	6	3,308,490	3.41%	1.66%	
Kalamazoo-Battle Creek MI	6	532,940	3.41%	0.27%	
Flint MI PMSA	4	6,073,026	2.27%	3.04%	
Benton Harbor MI	4	1,735,516	2.27%	0.87%	
Jackson MI	1	59,629	0.57%	0.03%	